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CONFIDENTIAL (FR)

**CURRENT ECONOMIC
and
FINANCIAL CONDITIONS**

Summary and Outlook

**Prepared for the
Federal Open Market Committee**

By the Staff

**BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM**

October 9, 1974

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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
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SUMMARY AND OUTLOOK

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Summary and Outlook

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. The staff is now estimating a somewhat larger decline in real GNP in the third quarter than was anticipated in the September Greenbook. Somewhat stronger-than-expected consumer outlays were more than offset by weaker expenditures on residential construction, plant and equipment, and inventory investment. In addition, net exports of goods and services now appear to have fallen more sharply than indicated five weeks ago, reflecting a significant jump in imports of oil and other industrial materials. Price increases continued intense last quarter and we now estimate that the GNP fixed-weighted index rose more rapidly in the third than in the second quarter.

Based on partial data, the industrial production index in September seems likely to remain unchanged, or perhaps to show a slight rise, following a .4 per cent decline in August. Settlement of labor disputes helped lift output in business equipment and the coal and copper industries, but output of consumer durable goods and construction materials apparently fell further.

Unemployment rose to 5.8 per cent in September as growth in the labor force substantially exceeded the gain in total employment. Unemployment rates were higher for almost all labor force groups. Non-farm payroll employment was about unchanged in September as it has been since May. However, construction employment fell in September and manufacturing employment after adjustment for strikes also declined. Factory hours of work were unchanged from the downward revised August level.

Consumer expenditures in the third quarter benefited from a surge in auto sales preceding the introduction of the considerably

higher priced 1975 models. In September, sales of domestic-type autos had dropped back to an annual rate of 8.1 million units, substantially below August's 9.5 million unit rate. Staff estimates are that the dollar volume of retail sales, excluding autos, was little changed last month, thus implying a decline in physical volume.

Housing starts fell further in August, and the third quarter average seems likely to be at an annual rate of about 1.2 million units, the lowest quarterly average in 7 years. New orders for nondefense capital goods also turned down sharply in August, following a large increase in July. Recent private surveys of 1975 capital spending intentions report that businessmen are expected to increase their dollar outlays in a 10-14 per cent range.

Wage rates, as measured by the hourly earnings index, continued to advance rapidly in September, and rose at an 11-1/2 per cent annual rate from the second to the third quarter. Consumer and wholesale prices rose rapidly in August, with increases widespread in both food and non-food categories. There is some recent evidence, however, of price weakness in certain basic industrial materials, such as copper, steel scrap, and lumber.

Outlook. Except for incorporating the Federal pay increase beginning October 1 rather than January 1, the monetary and fiscal assumptions underlying the projection are unchanged from the previous Greenbook. Because of time constraints, the staff has not yet been able to take into account the possible impact on economic activity and prices of the Administration's new economic proposals.

Key policy assumptions are: (1) growth in M_1 through calendar 1975 will be at an average annual rate of about 5-3/4 per cent; (2) a considerably expanded public employment program, to take effect by the spring of 1975; (3) Federal expenditures for fiscal 1975 of just under \$300 billion on a unified budget basis; (4) an increase in social security benefits of over \$4 billion to be effective July 1, 1975, as a result of automatic cost of living adjustments.

With indications of still further weakening in private sectors of the economy, we are projecting a faster rate of decline in real GNP for the fourth quarter than shown in the previous Greenbook.

In 1975, the pattern of GNP change is similar to the projections of 5 weeks ago. However, real GNP is now expected to decline a little more sharply over the first half of the year and then to pick up a little more rapidly late in the year.

For the current quarter, projected outlays for residential activity have been substantially reduced as a consequence of the recent sharp drop in housing starts. Gains in consumer spending, especially for durable goods, are expected to slow considerably, as outlays on household goods are projected to decline and as auto sales weaken as 1975 models become the dominant source of supply. Higher Federal spending stemming from the civilian and military pay increase on October 1 will serve to offset some of the weakness in other sectors. A higher rate of inventory investment is expected in the fourth quarter, reflecting mainly involuntary accumulation resulting from the projected decline in the rate of growth of final purchases. The continuing rapid rise in

prices, especially for nonfood consumer commodities and machinery and equipment has led the staff to raise the projected increase in the fixed-weighted private deflator for the fourth quarter.

The weaker pattern of consumer spending is now expected to persist as price increases continue large and job prospects uncertain. Partly in reaction to reduced consumer takings and high costs of carrying stocks businesses are expected to follow a cautious inventory policy. We have projected a gradual reduction in the rate of inventory accumulation over the year.

Housing starts, on a quarterly average basis, are expected to bottom out at a 1.1 million unit rate in the first quarter of 1975, and to rise gradually throughout the remainder of the year. Our pattern of business fixed investment is based on a year-over-year gain of 11 per cent for 1975. This increase is roughly consistent with the two recent private survey results and would imply little further real growth from this point on.

Recent developments suggest that price increases are likely to be somewhat higher in 1975 than was indicated earlier. However, as demands weaken, the rise in the fixed-weighted deflator is expected to slow to an 8 per cent rate by mid-1975 and to a 7 per cent rate by the end of the year.

The unemployment rate is expected to rise to about 7.0 per cent by mid-year and to about 7.5 per cent by year end, a somewhat sharper rise than was suggested five weeks ago. This projection assumes that growth in the labor force will slow and that employment declines in line with the somewhat poorer real economic performance now expected.

STAFF GNP PROJECTIONS

	<u>Per Cent Change, annual rate</u>							
	Changes in nominal GNP (\$ billion)		Real GNP		Gross private product fixed weighted price index		Unemployment Rate (Per cent)	
	9/4/74	10/9/74	9/4/74	10/9/74	9/4/74	10/9/74	9/4/74	10/9/74
1971 <u>1/</u>	77.8	77.8	3.3	3.3	4.3	4.3	5.9	5.9
1972 <u>1/</u>	103.1	103.1	6.2	6.2	3.3	3.3	5.6	5.6
1973 <u>1/</u>	136.9	136.9	5.9	5.9	6.3	6.3	4.9	4.9
1974	107.7	101.9	-1.4	-1.8	11.0	11.5 <u>2/</u>	5.5	5.5
1975	103.8	98.0	-.8	-1.6	8.3	9.7 <u>2/</u>	6.9	7.1
1973: I <u>1/</u>	44.2	44.2	9.5	9.5	7.4	7.4	5.0	5.0
II <u>1/</u>	29.0	29.0	2.2	2.2	8.1	8.1	4.9	4.9
III <u>1/</u>	31.0	31.0	1.6	1.6	8.4	8.4	4.7	4.7
IV <u>1/</u>	35.1	35.1	2.3	2.3	9.1	9.1	4.7	4.7
1974: I <u>1/</u>	14.8	14.8	-7.0	-7.0	14.1	14.1	5.2	5.2
II <u>1/</u>	28.5	25.0	-.8	-1.6	12.3	12.3	5.1	5.1
III <u>1/</u>	32.5	26.2	-.7	-2.0	10.9	13.5 <u>2/</u>	5.5	5.5
IV	24.5	24.5	-1.7	-3.1	9.1	11.1 <u>2/</u>	6.0	6.1
1975: I	22.0	19.0	-2.0	-2.7	7.8	9.5 <u>2/</u>	6.5	6.6
II	23.5	23.0	-.6	-1.0	7.1	8.0 <u>2/</u>	6.8	7.0
III	28.0	30.0	1.0	1.0	6.7	7.5 <u>2/</u>	7.1	7.3
IV	34.0	36.0	1.8	2.1	6.7	7.0 <u>2/</u>	7.3	7.5
Change:								
72-IV to 73-IV	139.3	139.3	3.9	3.9	8.3	8.3	-.6	-.6
73-IV to 74-IV	100.3	90.5	-2.6	-3.5	11.6	12.7 <u>2/</u>	1.3	1.4
74-II to 75-II	102.5	92.7	-1.3	-2.2	8.7	10.5 <u>2/</u>	1.7	1.9
74-IV to 75-IV	107.5	108.0	.0	-.2	7.1	8.0 <u>2/</u>	1.3	1.4

1/ Actual2/ Part of revisions from previous Greenbooks represents an improved procedure for estimating this series.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income
figures are billions of dollars, with quarter figures at annual rates.)

	1973	1974 Proj.	1973		1974		Projected	
			III	IV	I	II	III	IV
Gross National Product	1294.9	1396.8	1308.9	1344.0	1358.8	1383.8	1410.0	1434.5
Final purchases	1279.6	1384.3	1297.0	1315.1	1341.9	1370.3	1401.5	1423.5
Private	1003.2	1076.7	1020.1	1028.7	1045.6	1065.9	1090.2	1105.0
Excluding net exports	999.3	1078.5	1013.4	1019.4	1034.3	1067.4	1098.1	1114.2
Personal consumption expenditures	805.2	880.7	816.3	823.9	840.6	869.1	898.3	914.8
Durable goods	130.3	131.4	132.4	124.3	123.9	129.5	136.0	136.0
Nondurable goods	338.0	380.7	343.8	352.1	364.4	375.8	387.8	394.8
Services	336.9	368.7	340.1	347.4	352.4	363.8	374.5	384.0
Gross private domestic investment	209.4	210.3	209.0	224.5	210.5	211.8	208.3	210.4
Residential construction	57.2	46.6	58.1	53.6	48.4	48.8	46.8	42.4
Business fixed investment	136.8	151.2	139.0	141.9	145.2	149.4	153.0	157.0
Change in business inventories	15.4	12.5	11.8	28.9	16.9	13.5	8.5	11.0
Nonfarm	11.4	10.1	7.4	24.0	13.1	10.4	7.0	10.0
Net exports of goods and services ^{1/}	3.9	-1.8	6.7	9.3	11.3	-1.5	-7.9	-9.2
Exports	100.4	139.4	103.7	113.6	131.2	138.5	142.0	145.8
Imports	96.4	141.2	96.9	104.3	119.9	140.0	149.9	155.0
Gov't. purchases of goods and services	276.4	307.6	276.9	286.4	296.3	304.4	311.3	318.5
Federal	106.6	114.9	105.3	108.4	111.5	114.3	115.7	118.0
Defense	74.4	77.5	73.3	75.3	75.8	76.6	78.0	79.5
Other	32.2	37.4	32.0	33.1	35.7	37.7	37.7	38.5
State and local	169.8	192.8	171.6	177.9	184.8	190.1	195.6	200.5
Gross national product in constant (1958) dollars	839.2	824.2	840.8	845.7	830.5	827.1	822.9	816.4
GNP implicit deflator (1958 = 100)	154.3	169.5	155.7	158.9	163.6	167.4	171.4	175.7
Personal income	1055.0	1150.6	1068.0	1099.3	1112.5	1134.6	1167.2	1188.1
Wage and salary disbursements	691.7	753.3	698.2	717.0	727.6	745.2	764.0	776.4
Disposable income	903.7	979.6	913.9	939.4	950.6	966.5	992.2	1008.9
Personal saving	74.4	72.8	73.2	89.3	84.4	71.5	67.6	67.5
Saving rate (per cent)	8.2	7.5	8.0	9.5	8.9	7.4	6.8	6.7
Corporate profits & inventory val. adj.	105.1	104.0	105.2	106.4	107.7	105.6	101.8	100.9
Corporate profits before tax	122.7	145.2	122.7	122.7	138.7	143.5	152.0	146.5
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	258.5	293.4	261.8	268.3	279.4	290.3	300.3	303.6
Expenditures	264.2	296.0	263.4	270.6	281.0	291.6	303.4	308.0
Surplus or deficit (-)	-5.6	-2.6	-1.7	-2.3	-1.5	-1.3	-3.1	-4.4
High employment surplus or deficit (-)	-6.6	-1.3	-4.8	-4.2	-3.0	-3.5	-4.0	5.5
State and local government surplus or deficit (-), (N.I.A. basis)	9.2	2.5	8.4	4.6	3.4	2.2	3.2	1.2
Total labor force (millions)	91.0	93.3	91.3	92.2	92.8	92.9	93.6	93.8
Armed forces "	2.3	2.2	2.3	2.3	2.3	2.2	2.2	2.2
Civilian labor force "	88.7	91.0	89.0	89.9	90.5	90.6	91.4	91.6
Unemployment rate (per cent)	4.9	5.5	4.7	4.7	5.2	5.1	5.5	6.1
Nonfarm payroll employment (millions)	75.6	76.9	75.7	76.6	76.7	77.1	77.1	76.8
Manufacturing	19.8	19.8	19.8	20.1	19.9	19.9	19.9	19.6
Industrial production (1967 = 100)	125.6	125.0	126.7	127.0	124.9	125.5	125.4	124.1
Capacity utilization, mfg. (per cent)	83.0	79.5	83.3	82.6	80.5	80.2	79.3	77.9
Major materials (per cent)	93.0	89.3	93.5	92.3	90.2	90.2	89.3	87.4
Housing starts, private (millions, A.R.)	2.05	1.39	2.01	1.58	1.63	1.57	1.21	1.15
Sales new autos (millions, A.R.)	11.44	9.52	11.33	10.15	9.04	9.20	10.10	9.75
Domestic models	9.67	8.06	9.66	8.51	7.49	7.95	8.56	8.25
Foreign models	1.77	1.46	1.67	1.64	1.55	1.25	1.54	1.50
^{1/} Net exports of g. & s. (Bal. of Paymts.) ^{2/}	4.4	- .9	6.6	11.2	11.7	- .5	-6.9	-8.2
Exports ^{2/}	101.0	141.1	103.7	132.6	132.6	140.3	143.8	147.6
Imports	96.6	142.0	97.1	120.8	120.8	140.8	150.7	155.8

^{2/} Includes shipments of military equipment and supplies to Israel not included in GNP figures; for 1973-IV \$2.4 billion; 1974-I, \$.3 billions; 1974-II, III, IV, \$.4 billions each quarter.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1974 Proj.	1975 Proj.	1974 Proj.		1975 Proj.			
			III	IV	I	II	III	IV
Gross National Product	1396.8	1494.8	1410.0	1434.5	1453.5	1476.5	1506.5	1542.5
Final purchases	1384.3	1491.5	1401.5	1423.5	1447.5	1473.3	1504.9	1540.2
Private	1076.7	1154.8	1090.2	1105.0	1122.3	1141.9	1165.0	1190.0
Excluding net exports	1078.5	1164.1	1098.1	1114.2	1131.7	1151.1	1174.4	1199.3
Personal consumption expenditures	880.7	954.1	898.3	914.8	929.7	945.0	961.5	980.0
Durable goods	131.4	136.0	136.0	136.0	135.0	134.5	135.5	139.0
Nondurable goods	380.7	411.7	387.8	394.8	401.7	408.2	415.1	421.6
Services	368.7	406.4	374.5	384.0	393.0	402.3	410.9	419.4
Gross private domestic investment	210.3	213.3	208.3	210.4	208.0	209.3	214.4	221.6
Residential construction	46.6	42.3	46.8	42.4	40.3	40.1	43.1	45.8
Business fixed investment	151.2	167.8	153.0	157.0	161.7	166.0	169.8	173.5
Change in business inventories	12.5	3.3	8.5	11.0	6.0	3.2	1.6	2.3
Nonfarm	10.1	3.5	7.0	10.0	6.5	4.2	1.6	1.8
Net exports of goods and services ^{1/}	-1.8	-9.3	-7.9	-9.2	-9.4	-9.2	-9.4	-9.3
Exports	139.4	153.0	142.0	145.8	148.8	151.2	154.2	157.6
Imports	141.2	162.3	149.9	155.0	158.2	160.4	163.6	166.9
Gov't. purchases of goods and services	307.6	336.7	311.3	318.5	325.2	331.4	339.9	350.2
Federal	114.9	122.7	115.7	118.0	119.7	120.7	123.0	127.2
Defense	77.5	82.8	78.0	79.5	80.8	81.2	83.0	86.0
Other	37.4	39.9	37.7	38.5	38.9	39.5	40.0	41.2
State & local	192.8	214.0	195.6	200.5	205.5	210.7	216.9	223.0
Gross national product in constant (1958) dollars	824.2	811.3	822.9	816.4	810.8	808.7	810.7	814.9
GNP implicit deflator (1958 = 100)	169.5	184.3	171.3	175.7	179.3	182.6	185.8	189.3
Personal income	1150.6	1245.0	1167.2	1188.1	1207.8	1230.2	1257.7	1284.2
Wage and salary disbursements	753.3	813.4	764.0	776.4	789.1	804.2	820.4	840.0
Disposable income	979.6	1055.8	992.2	1008.9	1024.9	1043.4	1066.6	1088.3
Personal saving	72.8	74.6	67.6	67.5	68.0	71.2	77.7	81.6
Saving rate (per cent)	7.5	7.1	6.8	6.7	6.6	6.8	7.3	7.5
Corporate profits & inventory val. adj.	104.0	98.4	101.8	100.9	95.8	94.8	98.6	104.4
Corporate profits before tax	145.2	133.4	152.0	146.5	136.0	130.5	132.5	134.5
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	293.4	313.6	300.3	303.6	307.1	309.8	315.7	322.0
Expenditures	296.0	326.7	303.4	308.0	314.4	320.3	332.1	340.1
Surplus or deficit (-)	-2.6	-13.1	-3.1	-4.4	-7.3	-10.5	-16.4	-18.1
High employment surplus or deficit (-)	-1.3	19.6	-4.0	5.5	12.7	21.0	20.2	24.5
State and local government surplus or deficit (-), (N.I.A. basis)	2.5	-2.5	3.2	1.2	-1.0	-2.1	-2.8	-3.9
Total labor force (millions)	93.3	94.4	93.6	93.8	94.0	94.3	94.5	94.6
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	91.0	92.2	91.4	91.6	91.8	92.1	92.3	92.4
Unemployment rate (per cent)	5.5	7.1	5.5	6.1	6.6	7.0	7.3	7.5
Nonfarm payroll employment (millions)	76.9	76.5	77.1	76.8	76.6	76.5	76.4	76.3
Manufacturing	19.8	19.1	19.9	19.6	19.4	19.2	19.0	18.9
Industrial production (1967 = 100)	125.0	122.7	125.4	124.1	123.1	122.5	122.3	122.8
Capacity utilization, mfg. (per cent)	79.5	75.2	79.3	77.9	76.5	75.4	74.6	74.2
Major materials (per cent)	89.3	83.4	89.3	87.4	85.1	83.6	82.7	82.3
Housing starts, private (millions, A.R.)	1.39	1.25	1.21	1.15	1.10	1.20	1.30	1.40
Sales new autos (millions, A.R.)	9.52	8.95	10.10	9.75	9.15	8.75	8.75	9.15
Domestic models	8.06	7.45	8.56	8.25	7.65	7.25	7.25	7.65
Foreign models	1.46	1.50	1.54	1.50	1.50	1.50	1.50	1.50
^{1/} Net exports of g. & s. (Bal. of Paymts.)	- .9 ^{2/}	-8.3	-6.9 ^{2/}	-8.2 ^{2/}	-8.4	-8.2	-8.4	-8.3
Exports	141.1 ^{2/}	154.8	143.8 ^{2/}	147.6 ^{2/}	150.6	153.0	156.0	159.4
Imports	142.0	163.1	150.7	155.8	159.0	161.2	164.4	167.7

^{2/} Includes shipments of military equipment and supplies to Israel not included in GNP figures; for amounts, see table on preceding page.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1973	1974 Proj.	1973		1974		Projected	
			III	IV	I	II	III	IV
-----Billions of Dollars-----								
Gross National Product	136.9	101.9	31.0	35.1	14.8	25.0	26.2	24.5
Inventory change	6.9	-2.9	1.1	17.1	-12.0	-3.4	-5.0	2.5
Final purchases	130.0	104.7	29.8	18.1	26.8	28.4	31.2	22.0
Private	109.3	73.5	26.2	8.6	16.9	20.3	24.3	14.8
Net exports	9.9	-5.7	6.2	2.6	2.0	-12.8	-6.4	-1.3
Excluding net exports	99.4	79.2	20.0	6.0	14.9	33.1	30.7	16.1
Personal consumption expenditures	76.2	75.5	17.3	7.6	16.7	28.5	29.2	16.5
Durable goods	11.9	1.1	.3	-8.1	-.4	5.6	6.5	.0
Nondurable goods	38.0	42.7	11.1	8.3	12.3	11.4	12.0	7.0
Services	26.0	31.8	5.9	7.3	5.0	11.4	10.7	9.5
Residential fixed investment	3.2	-10.6	-.6	-4.5	-5.2	.4	-2.0	-4.4
Business fixed investment	20.0	14.4	3.4	2.9	3.3	4.2	3.6	4.0
Government	20.7	31.2	3.6	9.5	9.9	8.1	6.9	7.2
Federal	1.7	8.3	-.9	3.1	3.1	2.8	1.4	2.3
State and local	19.0	23.0	4.5	6.3	6.9	5.3	5.5	4.9
GNP in constant (1958) dollars	46.7	-15.0	3.4	4.9	-15.2	-3.4	-4.2	-6.5
Final purchases	43.0	-11.5	3.1	-7.0	-5.8	-1.0	-1.0	-7.1
Private	45.2	-12.4	3.3	-9.0	-6.1	-.8	-.2	-6.5
-----Per Cent Per Year ^{1/} -----								
Gross National Product	11.8	7.9	10.1	11.2	4.5	7.6	7.8	7.1
Final purchases	11.3	8.2	9.7	5.7	8.4	8.7	9.4	6.4
Private	12.2	7.3	11.0	3.4	6.7	8.0	9.4	5.5
Personal consumption expenditures	10.5	9.4	8.9	3.8	8.4	14.3	14.1	7.6
Durable goods	10.1	.8	.9	-22.3	-1.3	19.3	21.6	.0
Nondurable goods	12.8	12.6	14.0	10.0	14.7	13.1	13.4	7.4
Services	8.4	9.4	7.3	8.9	5.9	13.6	12.3	10.5
Gross private domestic investment	16.8	.4	7.8	33.1	-22.7	2.5	-6.4	4.1
Residential structures	5.9	-18.5	-4.0	-27.6	-33.5	3.3	-15.4	-32.6
Business fixed investment	17.1	10.5	10.4	8.6	9.6	12.1	10.0	10.9
Gov't. purchases of goods & services	8.1	11.3	5.4	14.4	14.6	11.4	9.4	9.6
Federal	1.6	7.8	-3.3	12.3	11.9	10.4	5.0	8.2
Defense	-.5	4.2	-3.7	11.4	2.7	4.3	7.5	7.9
Other	7.0	16.1	-2.5	14.5	35.3	24.4	.0	8.8
State and local	12.6	13.5	11.2	15.5	16.4	12.0	12.1	10.4
GNP in constant (1958) dollars	5.9	-1.8	1.6	2.3	-7.0	-1.6	-2.0	-3.1
Final purchases	5.5	-1.4	1.5	-3.3	-2.8	-.5	-.5	-3.4
Private	6.5	-1.8	1.9	-5.1 ^{2/}	-3.5 ^{2/}	-.5	-.1	-3.8 ^{2/}
GNP implicit deflator	5.6	9.9	8.3	8.6 ^{2/}	12.3 ^{2/}	9.3	10.1	10.6 ^{2/}
Private GNP fixed weighted index ^{3/}	6.3	11.5	8.4	9.1	14.1	12.3	13.5	11.1
Personal income	11.7	9.1	11.6	12.2	4.9	8.2	12.0	7.4
Wage and salary disbursements	10.3	8.9	8.7	11.2	6.0	10.0	10.5	6.7
Disposable income	12.6	8.4	10.1	11.6	4.9	6.9	11.1	6.9
Corporate profits before tax	23.7	18.3	-6.9	.0	63.3	14.6	25.9	-13.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	13.8	13.5	11.1	10.3	17.6	16.5	14.5	4.5
Expenditures	8.0	12.0	1.5	11.4	16.3	16.0	17.2	6.2
Nonfarm payroll employment	5.9	1.8	2.2	4.4	.8	1.8	.2	-1.6
Manufacturing	4.7	-.1	1.2	4.5	-2.9	.4	-1.4	-5.4
Industrial production	9.0	-.5	6.2	1.0	-6.5	1.6	-.3	-3.8
Housing starts, private	-13.2	-32.0	-32.0	-61.4	11.6	-14.4	-64.4	-18.4
Sales new autos	4.7	-16.8	-21.3	-35.5	-37.1	7.4	45.4	-13.2
Domestic models	3.7	-16.6	-18.6	-39.5	-40.0	27.1	34.3	-13.6
Foreign models	9.8	-17.5	-35.0	-5.9	-20.0	-57.8	132.2	-10.7

^{1/} Percentage rates are annual rates compounded quarterly.

^{2/} Excluding Federal pay increases rates of change are: 1973-IV, 8.0 per cent; 1974-I, 12.2 per cent, and 1974-IV, 10.0 per cent.

^{3/} Using expenditures in 1967 as weights.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974 Proj.	1975 Proj.	1974		1975 Projected		1975 III	1975 IV
			III	IV	I	II		
-----Billions of Dollars-----								
Gross National Product	101.9	98.0	26.2	24.5	19.0	23.0	30.0	36.0
Inventory change	-2.9	-9.2	-5.0	2.5	-5.0	-2.8	-1.6	.7
Final purchases	104.7	107.2	31.2	22.0	24.0	25.8	31.6	35.3
Private	73.5	78.1	24.3	14.8	17.3	19.6	23.1	25.0
Net exports	-5.7	-7.5	-6.4	-1.3	-.2	.2	-.2	.1
Excluding net exports	79.2	85.6	30.7	16.1	17.5	19.4	23.3	24.9
Personal consumption expenditures	75.5	73.4	29.2	16.5	14.9	15.3	16.5	18.5
Durable goods	1.1	4.6	6.5	.0	-1.0	-.5	1.0	3.5
Nondurable goods	42.7	31.0	12.0	7.0	6.9	6.5	6.9	6.5
Services	31.8	37.7	10.7	9.5	9.0	9.3	8.6	8.5
Residential fixed investment	-10.6	-4.3	-2.0	-4.4	-2.1	-.2	3.0	2.7
Business fixed investment	14.4	16.6	3.6	4.0	4.7	4.3	3.8	3.7
Government	31.2	29.1	6.9	7.2	6.7	6.2	8.5	10.3
Federal	8.3	7.8	1.4	2.3	1.7	1.0	2.3	4.2
State and local	23.0	21.2	5.5	4.9	5.0	5.2	6.2	6.1
GNP in constant (1958) dollars	-15.0	-12.9	-4.2	-6.5	-5.6	-2.1	2.0	4.2
Final purchases	-11.5	-7.5	-1.0	-7.1	-3.1	-.8	2.7	3.6
Private	-12.4	-7.2	-.2	-6.5	-2.8	-.9	1.6	2.8
-----Per Cent Per Year ^{1/} -----								
Gross National Product	7.9	7.0	7.8	7.1	5.4	6.5	8.4	9.9
Final purchases	8.2	7.7	9.4	6.4	6.9	7.3	8.9	9.7
Private	7.3	7.3	9.4	5.5	6.4	7.2	8.3	8.9
Personal consumption expenditures	9.4	8.3	14.1	7.6	6.7	6.7	7.2	7.9
Durable goods	.8	3.5	21.6	.0	-2.9	-1.5	3.0	10.7
Nondurable goods	12.6	8.1	13.4	7.4	7.2	6.6	6.9	6.4
Services	9.4	10.2	12.3	10.5	9.7	9.8	8.8	8.5
Gross private domestic investment	.4	1.4	-6.4	4.1	-4.5	2.5	10.1	14.1
Residential structures	-18.5	-9.2	-15.4	-32.6	-18.4	-2.0	33.5	27.5
Business fixed investment	10.5	11.0	10.0	10.9	12.5	11.1	9.5	9.0
Gov't. purchases of goods & services	11.3	9.5	9.4	9.6	8.7	7.8	10.7	12.7
Federal	7.8	6.8	5.0	8.2	5.9	3.4	7.8	14.4
Defense	4.2	6.8	7.5	7.9	6.7	2.0	9.2	15.3
Other	16.1	6.7	.0	8.8	4.2	6.3	5.2	12.6
State and local	13.5	11.0	12.1	10.4	10.4	10.5	12.3	11.7
GNP in constant (1958) dollars	-1.8	-1.6	-2.0	-3.1	-2.7	-1.0	1.0	2.1
Final purchases	-1.4	-.9	-.5	-3.4	-1.5	-.4	1.3	1.8
Private	-1.8	-1.1	-.1	-3.8 ^{2/}	-1.7 ^{2/}	-.5	1.0	1.7 ^{2/}
GNP implicit deflator	9.9	8.7	10.0	10.6 ^{2/}	8.4 ^{2/}	7.6	7.3	7.7 ^{2/}
Private GNP fixed weighted index ^{3/}	11.5	9.7	13.5	11.1	9.5	8.0	7.5	7.0
Personal income	9.1	8.2	12.0	7.4	6.8	7.6	9.2	8.7
Wage and salary disbursements	8.9	8.0	10.5	6.7	6.7	7.9	8.3	9.9
Disposable income	8.4	7.8	11.1	6.9	6.5	7.4	9.2	8.4
Corporate profits before tax	18.3	-8.1	25.9	-13.7	-25.7	-15.2	6.3	6.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	13.5	6.9	14.5	4.5	4.7	3.6	7.8	8.2
Expenditures	12.0	10.4	17.2	6.2	8.6	7.7	15.6	10.0
Nonfarm payroll employment	1.8	-.5	.2	-1.6	-1.0	-.5	-.5	-.5
Manufacturing	-.1	-3.5	-1.4	-5.4	-4.0	-4.1	-4.1	-2.1
Industrial production	-.5	-1.8	-.3	-3.8	-3.3	-2.1	-.6	1.8
Housing starts, private	-32.0	-10.1	-64.4	-18.4	-16.3	41.6	37.7	34.5
Sales new autos	-16.8	-6.0	45.4	-13.2	-22.4	-16.4	.0	19.6
Domestic models	-16.6	-7.6	34.3	-13.6	-26.1	-19.3	.0	24.0
Foreign models	-17.5	2.7	132.2	-10.7	.0	.0	.0	.0

^{1/} Percentage rates are annual rates compounded quarterly.

^{2/} Excluding Federal pay increases rates of change are: 1974-IV, 10.0 per cent; 1975-I, 8.2 per cent; and 1975-IV, 7.0 per cent.

^{3/} Using expenditures in 1967 as weights.

DOMESTIC FINANCIAL SITUATION

Summary. Since the September meeting, short-term market rates of interest have declined about 1 to 2 percentage points. These declines occurred as market expectations that monetary policy and credit market conditions would ease were strengthened by the continuing decline in the Federal funds rate, weakness in the monetary aggregates, increased reports of sluggish economic activity, and most recently, by anticipation of the President's proposed economic program. The largest declines in short-term rates occurred on 90-day Treasury bills, reflecting large foreign and System purchases at the same time as the Treasury retired a sizable amount of maturing bills.

Capital markets did not generally share in the improved market atmosphere until the last few days, as investors focused instead on the large expected volume of corporate and municipal borrowing in the months ahead. For most of the period since the last committee meeting, stock prices declined sharply further, and corporate bond yields rose to new highs.

Business credit flows dropped sharply in September. Business loans at banks showed essentially no growth after seasonal adjustment. Although commercial paper volume increased substantially as rates in these markets declined sharply, total short-term business credit expanded by considerably less than in preceding months. In the corporate bond market, new offerings were also quite small, as corporations tended to hold back while awaiting clearer indications of

market developments. While some moderation in business credit demands was to be expected, the dimension of the September decline appears larger than is consistent with our GNP projections. In early October, both business loans at New York City banks and corporate bond offerings increased substantially.

Bank lending policies appear to have tightened further in the late summer, and banks report only slight easing in underlying demands for bank credit. With demand deposits showing no growth and weakness developing in small-denomination time deposit inflows, banks have continued to liquidate securities and have also stepped up their CD offerings. Borrowing from foreign branches declined substantially, as domestic rates declined more than Euro-dollar rates.

At thrift institutions, there was a sizable seasonally adjusted increase in deposits in September, apparently reflecting large interest-crediting. However, withdrawals of funds continued to be substantial at these institutions, though at a more moderate pace than in August. New mortgage commitments of S&L's have continued to decline, and interest rates on new commitments for home mortgages have risen 15 to 20 basis points since the September meeting and now average approximately 10 per cent nationwide.

Most recently, however, the declines in short-term market rates have engendered some market expectations of an easing in the mortgage market. In the late September FNMA auction, average yields on forward purchase commitments edged down slightly on a sharply

reduced volume. There were also reports that some mortgage bankers had increased their inventories in expectation of rate declines.

Outlook. Credit demands are expected to be relatively large during the fourth quarter, particularly in bond markets. The calendar of forthcoming corporate bond offerings, for example, suggests that new issues in October and November will be the largest since 1971, as businesses, with internal funds under pressure, are turning to longer-term markets to finance capital outlays. The staff projections of total corporate and State and local security offerings this month and next are almost 50 per cent larger than the third quarter average. At the same time, Treasury and agency new money demands are expected to be around \$10 billion in the closing months of 1974. The forthcoming large volume of capital market issues will tend to limit declines in long-term rates, even assuming a further drop in short-term market rates. And if market participants' expectations of a further easing of monetary policy are not confirmed, long-term yields could rise.

Although loan growth at commercial banks is unlikely to be as small as in September, business loan demands are expected to continue to moderate as the pace of inventory accumulation remains below that of the first half. Easing of loan demands and reduced cost of funds to banks may lead to further reductions in the prime rate, but strained liquidity positions at banks make it unlikely

that their nonprice lending policies will be eased noticeably. In short-term markets generally, interest rates have already undergone a considerable downward adjustment, and might not decline significantly more unless the federal funds market shows further signs of ease.

Additional declines in short-term market rates are probably required for the position of thrift institutions to begin to improve and for home mortgage rates in the primary market to show noticeable declines. Even with some improvement in thrift institution inflows in the fourth quarter, no substantial upturn in new mortgage commitments seems likely, as the institutions would first concentrate on rebuilding liquidity and repaying high cost debt.

INTERNATIONAL DEVELOPMENTS

Summary and outlook. The steady rise in the exchange value of the dollar since May gave way to an easing tendency early in September, resulting in a drop of 1 per cent in the past five weeks. Some of the weakness over the past month probably reflects the deepening U.S. trade deficit, which was at an annual rate of \$15 billion in August, although announcement of the deficit had no immediate market impact. Another influence in the market has probably been the evidence of some easing of monetary policy here, although there are also signs of easing in some countries abroad. Also depressing the dollar were uncertainties about the general course of U.S. policy domestically, and the recent reimposition of limitations on agricultural exports.

Foreign lending by U.S. banks remained high at about \$1-1/2 billion in August, raising the total reported increase in claims on foreigners for the year to \$15 billion. On the other side of the ledger, banks' liabilities to private foreigners were up nearly \$3 billion in August, and up \$13 billion since the beginning of the year. More recently, as short-term interest rates here eased relative to Euro-dollar rates, there has been a sharp reduction in liabilities to private foreigners (including foreign branches).

Other private capital transactions may be showing larger outflows than in the first half of the year. U.S. direct investors have announced sizable plans for foreign outlays, and the petroleum companies in particular were probably making large payments in

September to cover current and retroactive tax liabilities. Moreover, net foreign purchases of U.S. corporate stocks, a major inflow in the past several years, have been negligible since April, though there was a slight pick-up in August. U.S. corporations are no longer borrowing substantial amounts abroad to finance direct foreign investments, and in fact have been liquidating some earlier term borrowing from foreign banks, so that there is likely to be a greater use of U.S.-source funding.

Changes in foreign official accounts in the United States are now dominated by the build-up of oil producers' funds, with partial data suggesting gains averaging about \$1-1/4 billion per month in the third quarter.

In the period ahead it seems unlikely that the trade balance will worsen further. The large July-August deficits probably include some anticipatory inventory building, and imports in the months ahead should be damped by the projected low levels of final demand. Flows of capital will be influenced largely by the course of monetary policy here and abroad, together with the decisions made by OPEC countries on the placement of their funds. Given the large current account deficits to be financed, any reduction in incentives for capital to flow to the United States would result in some pressure on the dollar rate.